(4)

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1941

No. 1192

CAMILLE R. GUMP, Executrix, EDWIN LETTS OLIVER, Executor of the Estate of Alfred S. Gump, Deceased,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI
to the United States Circuit Court of Appeals
for the Ninth Circuit
and
BRIEF IN SUPPORT THEREOF.

CHELLIS M. CARPENTER,
CHARLES A. CHRISTIN,
WALTER CHRISTIE,
Russ Building, San Francisco, California,
Counsel for Petitioners.

Subject Index

Table of Authorities Cited

Codes and Statutes

Texts

Miscellaneous

In the Supreme Court
OF THE
United States

October Term, 1941

No.

Camille R. Gump, Executrix, Edwin Letts Oliver, Executor of the Estate of Alfred S. Gump, Deceased, *Petitioners,* vs. Commissioner of Internal Revenue, *Respondent.*	

PETITION FOR WRIT OF CERTIORARI to the United States Circuit Court of Appeals for the Ninth Circuit.

To the Honorable Harlan Fiske Stone, Chief Justice of the United States, and to the Associate Justices of the Supreme Court of the United States:

Your petitioners, Camille R. Gump, executrix, and Edwin Letts Oliver, executor of the estate of Alfred S. Gump, deceased, respectfully show:

A.

SUMMARY STATEMENT OF THE MATTER INVOLVED.

Petitioners are, respectively, the executrix and executor of the estate of Alfred S. Gump, deceased, who was born in the United States on January 30, 1866, and died on January 23, 1934, being at the time of his death a resident of the City and County of San Francisco, State of California. In due course decedent's last will and testament was admitted to probate, and Camille R. Gump was appointed executrix, and Edwin Letts Oliver executor thereof. Appropriately, a Federal estate tax return was filed, in which one-half of the estate was returned, it being the contention that the remainder of the estate was community property which belonged to Camille R. Gump.

Decedent married Camille R. Gump on March 28, 1905. At that time he was a stockholder and an employe of S. & G. Gump Company, a corporation. The stock so held by decedent had a book value of $41,636.00. (R. 91-92.) S. & G. Gump Company were art dealers, and suffered a loss as a result of the earthquake and fire of April 18, 1906. Operation of the business ceased for several months, but was resumed about November 3, 1906. At that time the surplus of the Company had entirely disappeared, and the book value and the par value of the stock was $200,000.00, making the value of the shares held by Alfred S. Gump, $25,000.00. (R. 92.) The business of S. & G. Gump Company was owned entirely at that time by Abraham L. Gump, William E. Gump and the decedent, all of whom were brothers. From March

28, 1905, to February 9, 1929, decedent and his brothers devoted their entire time and efforts to the development and building up of the business of S. & G. Gump Company, and the success of that company was largely due not to the invested capital, but to the ability, hard work and efforts of the decedent and his two brothers. (R. 93-94.)

On or about March 2, 1911, decedent and his two brothers incorporated the S. & G. Gump Realty Company with an authorized capital of $20,000.00, consisting of 40 shares of common stock of the par value of $500.00 each, of which 15 shares were issued to decedent. (R. 89, 95-96.)

Between March 28, 1905, the date of decedent's marriage to Camille R. Gump, and February 9, 1929, there was issued in the name of decedent 2639 shares of the common stock of S. & G. Gump Company, and as of February 9, 1929, decedent held 2664 shares of the outstanding common stock of said company. (R. 94.)

During the period from July 29, 1927 (which was the effective date of the last amendment of the Community Property Law of the State of California) to December 31, 1928, the earned surplus of S. & G. Gump Company increased by $557,510.08. This increase amounted to $74.335 per share on the 7500 shares of the common stock of the corporation outstanding at each of these dates. This increase in the surplus constituted an increase of $198,028.44 in the book value of the 2664 shares of the common stock of the corporation held by decedent, Alfred S. Gump.

This increase of the earned surplus was after making provision for cash dividends of \$45,000.00 on the common stock which was paid early in 1929, and after deduction for a reserve of \$68,972.57 for the 1928 income tax. (R. 90-91.)

On February 9, 1929, decedent and Camille R. Gump, his wife, by written contract, sold to Abraham L. Gump 2710 shares of the common stock of S. & G. Gump Company, and 15 shares of the capital stock of S. & G. Gump Realty Company for a total consideration of \$1,184,994.45, \$500,000.00 of this consideration was paid in cash on February 9, 1929, and the balance was payable in installments over a period of years. (R. 72.)

The contract provided that the consideration to be paid for the 2710 shares of the capital stock should be the book value of said stock as it appeared on the books of the corporation at the close of business December 31, 1928. On December 23, 1929, a second contract was made between decedent and Camille R. Gump and Abraham L. Gump, in which it was agreed that the price to be paid for the 2710 shares of the common stock of S. & G. Gump Company should be the sum of \$1,100,976.25, and the 15 shares of the capital stock of S. & G. Gump Realty Company should be the sum of \$84,018.20, making a total of \$1,184,994.45. (R. 78.)

At the time of the death of Alfred S. Gump, besides the \$500,000.00 down payment on February 9, 1929, there had been paid \$300,000.00 on the installment obligation, making a total payment of \$800,000.00, and

leaving an unpaid balance at the time of the death of decedent of $384,994.45. (R. 69.)

During his lifetime decedent had reported his income for Federal tax purposes on the basis of a calendar year. He used the cash receipt and cash disbursement basis. After their qualification the executrix and executor of his estate filed a Federal income tax return for the calendar year of 1933, and also a Federal income tax return for the period from January 1 to January 23, 1934, the date of death. These returns used the same basis of cash receipts and disbursements, except as to items of accrual of income and deductions required to be included in the last mentioned return, in accordance with Sections 42 and 43 of the Revenue Act of 1934. (R. 70.)

The unrealized gains upon the installment contract were not reported in the last mentioned return as a bond was filed with the Commissioner in accordance with Sec. 44 (d) of the Revenue Act of 1934. (R. 85-87.)

Respondent determined that the sale of said shares under said contracts of February 9, 1928, and December 23, 1928, was on the installment basis. Respondent also determined that 74.0458% of each dollar collected on said $384,994.45 subsequent to death was taxable income to the estate. The respondent has refused to treat the payments so made to the estate as payments of principal applicable to said principal obligation. (R. 93.)

The Federal estate tax return (R. 98-122) filed by the executrix and executor, showed a total net tax

of $12,554.80, which was paid on January 27, 1935. Respondent examined and audited the return, and determined that the value of the gross estate subject to the Federal estate tax was $802,737.41, and that the taxable net estate under the 1926 Act was $535,-889.29, and that the taxable net estate under the 1932 Act was $585,889.29. (R. 70-71.)

In his determination of the value of the gross and net estate, the respondent did not exclude from the value of the gross estate any amount whatsoever as and for the community property interest of Camille R. Gump existing at the date of decedent's death. (R. 71.)

Included in the gross estate of $802,737.41 found by the respondent is the sum of $384,994.45, being the amount of the unpaid installment obligation under the contracts of February 9, 1929, and December 23, 1929.

The respondent determined that there was a deficiency of $32,175.18. The petitioners appealed to the Board of Tax Appeals from the determination of the respondent, asserting that the amount of the deficiency in the sum of $32,175.18 was improper, and alleged that a refund of the amount theretofore paid by the petitioners as an estate tax in the sum of $12,554.86 was proper. The Board of Tax Appeals sustained the action of the Commissioner of Internal Revenue in the major part, holding that no refund in the amount theretofore paid as an estate tax should be granted, and that a deficiency existed in the estate tax in the sum of $32,010.02. On October 9, 1940, the Board

entered its decision ordering and deciding that there was a deficiency in the estate tax in the amount of $32,010.02. (R. 52.)

B.

QUESTIONS PRESENTED.

This petition for writ of certiorari presents the following questions:

1. Whether or not community property accumulated by a resident of California subsequent to the effective date of the amendment to Section 161a of the Civil Code of the State of California (July 29, 1927) is to be included in the gross estate of the decedent for Federal estate tax purposes, or whether one-half of such community property is to be included.

2. Whether or not community property accumulated by a decedent subsequent to the 1923 amendment to Section 1401 of the Civil Code of the State of California (now Section 201 of the Probate Code) is to be included in its entirety in the gross estate of the decedent for Federal estate tax purposes, or whether only one-half thereof shall be included.

3. Whether or not the full face value of unpaid installment obligations is to be included in the gross estate of a decedent for Federal estate tax purposes where such decedent during his lifetime reported for income tax purposes the gains thereof under the installment method provided for by Section 44 of the Internal Revenue Act, and where the estate, by reason of filing of bond under Section 44 (d), is

obligated to pay income tax, the same as decedent would have paid had he lived.

4. Whether petitioners are entitled under the authority of *Bull v. United States,* 294 U. S. 247, to an offset against the estate tax in the amount of income tax payable by the estate upon the gains realized upon collection of the installment obligations subsequent to death.

C.

BASIS UPON WHICH IT IS CONTENDED THE SUPREME COURT HAS JURISDICTION TO REVERSE THE JUDGMENT OF THE CIRCUIT COURT OF APPEALS.

1. The United States Circuit Court of Appeals for the Ninth Circuit failed to pass upon and determine the effect of the 1923 amendment to Section 201 of the Probate Code of the State of California with reference to the character of the wife's interest in community property accumulated from that date forward.

2. The decision of the United States Circuit Court of Appeals for the Ninth Circuit in refusing to be bound by or follow the decisions of the Supreme Court of the State of California in the cases of *Pereira v. Pereira,* 156 Cal. 1, *Estate of Fellows,* 106 Cal. App. 681, *In re Gold Estate,* 170 Cal. 621, and the Supreme Court of the State of Washington, *In re Buchanan's Estate,* 154 Pac. 129, and Section 161a of the *Civil Code of California* with reference to the accretion to community property of capital accumulated wholly by the efforts of the husband during coverture is in

conflict with the applicable decisions of the United States Supreme Court.

3. The decision of the United States Circuit Court of Appeals for the Ninth Circuit holding that the Board of Tax Appeals did not commit error when it held that the Commissioner of Internal Revenue properly included in the gross estate of the decedent all unrealized gains on installment obligations, said gains also being subject to an income tax when collected, is contrary to the decision of the United States Supreme Court in the case of *Bull v. United States*, 295 U. S. 247, and in conflict with the case of *Nichols v. United States*, 64 Court of Claims 241, certiorari denied 277 U. S. 584, and the Court erred when it held that no credit against the Federal estate tax could be given for the $25,877.59 income tax imposed upon the gains under the installment contract.

4. The decision of the United States Circuit Court of Appeals for the Ninth Circuit holding that the Board of Tax Appeals did not commit error when it held that under the Revenue Act of 1928 the entire gain on the sale of the shares of stock of S. & G. Gump Company on the installment basis was realized in 1929.

Wherefore, your petitioners respectfully pray that a writ of certiorari be issued out of and under the seal of this Honorable Court directed to the Circuit Court for the Ninth Circuit, commanding that Court to certify and send to this Court, for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all

proceedings in the case numbered and entitled on its docket "No. 9825, Camille R. Gump, Executrix, Edwin Letts Oliver, Executor of the Estate of Alfred S. Gump, Deceased, Petitioners, vs. Commissioner of Internal Revenue, Respondent", and that the said judgment of said Circuit Court may be reversed by this Honorable Court, and that your petitioners may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioners will ever pray.

Dated, San Francisco, California,
April 27, 1942.

Chellis M. Carpenter,
Charles A. Christin,
Walter Christie,
Counsel for Petitioners.

Certificate of Counsel.

I, the undersigned, Chellis M. Carpenter, do hereby certify that I am one of the counsel for the petitioners above named; that in my opinion the petition is well founded in point of fact and law, and is not interposed for purposes of delay.

Dated, San Francisco, California,
April 27, 1942.

Chellis M. Carpenter,
Counsel for Petitioners.

In the Supreme Court

OF THE

United States

October Term, 1941

No.

Camille R. Gump, Executrix, Edwin Letts Oliver, Executor of the Estate of Alfred S. Gump, Deceased,
Petitioners,

vs.

Commissioner of Internal Revenue,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

OPINIONS OF LOWER COURTS.

(a) The judgment of the Board of Tax Appeals was entered October 9, 1940.

(b) The opinion of the Circuit Court of Appeals was rendered and filed December 31, 1941, and is cited in 124 Fed. (2d) 540; the said judgment was entered in December 31, 1941, and is set forth at pages 248-256 of the record.

(c) A petition for rehearing was filed in the Circuit Court of Appeals on January 30, 1942, and denied on February 3, 1942.

II.

GROUNDS ON WHICH JURISDICTION OF THE COURT IS INVOKED.

The jurisdiction of this Court is invoked under the provisions of the Judicial Code, Section 240, as amended by the Act of February 13, 1925. (Sec. 347, Title 28, United States Code Annotated.) The Circuit Court of Appeals for the Ninth Circuit on December 31, 1941, affirmed the order of the United States Board of Tax Appeals upholding the additional assessment by the Commissioner of Internal Revenue. (R. 248-256.) Petitioners thereafter, on the 30th day of January, 1942, filed a petition for a rehearing in said Court within the time allowed therefor, which petition was denied on February 3, 1942. (R. 258.)

III.

STATEMENT OF THE CASE.

A full statement of the case has been given under the heading A in the petition, and in the interests of brevity the statement is not repeated at this point.

IV.

SPECIFICATIONS OF ERROR.

A. The United States Circuit Court of Appeals erred in not deciding the effect of the 1923 amendment to Section 1401 of the Civil Code of California (now Section 201 of the Probate Code of California), which provides that upon the death of either husband or wife, one-half of the property belongs to the surviving spouse. The other half is subject to the testamentary disposition of decedent, and in the absence thereof goes to the surviving spouse subject to the provisions of Sections 202 and 203 of the Probate Code.

B. The Circuit Court of Appeals erred in holding that no part of the increment of decedent's estate acquired subsequent to July 29, 1927, was community property of the unrestricted type, all of the increment having been acquired subsequent to the taking effect of the 1927 amendment to the Community Property Laws of the State of California (Sec. 161a of the Civil Code of California).

C. The United States Circuit Court of Appeals erred in holding, without evidence and contrary to stipulation, that the salary paid to the husband subsequent to July 29, 1927, was fully compensatory of all his efforts and therefore no accretion to community property owner, this despite the stipulation found in the record that the entire success of his company was due to the efforts of his brothers and himself.

D. The United States Circuit Court of Appeals erred in holding that the same property can be both

taxable income to the estate of a decedent and at the same time be corpus thereof and taxable as part of the gross estate under the Federal estate tax, and that the unrealized gains on the installment obligation must be included in the gross Federal estate tax return at their fair market value as of the date of death.

E. The United States Circuit Court of Appeals erred in holding in this case where a bond under Section 44 (d) had been filed that unrealized gains upon installment obligations transmitted by death of the holder thereof subjects his estate to an income tax, and at the same time the full face value of the unpaid installments must be included in the gross estate of the decedent taxable for Federal estate tax purposes.

F. The United States Circuit Court of Appeals erred in holding that the executors were not entitled to a credit or an offset against Federal estate taxes of the amount paid by them or obligated to be paid by them for income tax to the estate on the unrealized gains upon installment obligations transmitted by the death of decedent.

V.

ARGUMENT.

SUMMARY OF ARGUMENT.

Point A. The United States Circuit Court of Appeals erred when it failed to pass upon the question of the effect of the 1923 amendment to Section 1401 of the Civil Code of the State of California (now

Section 201 of the Probate Code), by which the wife acquired the right to dispose of one-half of the community property by her will and testament. One-half of such community property as was acquired from this date on in 1923 should have been excluded from the gross estate of decedent.

Point B. It was error of the United States Circuit Court of Appeals in holding that there was no increment to the wife in the community property of the decedent and his wife, Camille R. Gump, acquired from July 29, 1927 on, that being the date of the amendment to the California Community Property Law by which the wife's interest was fixed as a present, existing and equal interest, and therefore one-half such community property should have been excluded from the gross estate of decedent.

Point C. The United States Circuit Court of Appeals erred in holding without evidence and contrary to the stipulation (R. 93-94) that all salary paid to the husband subsequent to July 29, 1927, was fully compensatory of all his efforts, and therefore there was no accretion to the community property estate. It was distinctly stipulated by the parties that the success of the business was due to the efforts and energy of the three brothers.

Point D. The United States Circuit Court of Appeals erroneously decided that the full face value of unpaid installment obligations were to be included in the gross estate of decedent despite the fact that the decedent's executors had either paid, or obligated themselves to pay, an income tax upon these unrealized gains transmitted by the death of decedent.

Point E. The United States Circuit Court of Appeals erred in holding that though the unrealized gains upon the installment obligations transmitted by death of the holder thereof were subject to income tax to be paid his estate the same unrealized gain should be included in gross estate for Federal estate tax purposes.

Point F. The United States Circuit Court of Appeals, in refusing to allow an offset against Federal estate taxes of the amount paid by the petitioners, or which they obligated themselves to pay for income tax upon the unpaid installment obligations transmitted by the death of the decedent, decided contrary to the law as established in the cases of *Bull v. United States*, 295 U. S. 247, 79 L. ed. 1421, and *Nichols v. United States*, 64 Court of Claims 241.

POINT A.

The Commissioner included in the gross estate for Federal estate tax purposes all of the community property. In doing this, it is contended that he committed error in that he did not consider the statutory provisions of the amendment of 1923 to Section 201 of the Probate Code of the State of California.

Alfred S. Gump, the decedent, married Camille R. Gump on March 28, 1905. At that time he was a stockholder, together with his two brothers, of S. & G. Gump Company, and all of the stock of said company was owned by Alfred S. Gump, Abraham L. Gump and William E. Gump. Operation of the business

ceased for several months after the earthquake and fire of April 18, 1906. At that time the surplus of the company had entirely disappeared, and the book value and the par value of the stock was $200,000.00, making the value of the shares held by Alfred S. Gump $25,000.00. (R. 92.) The three brothers continued to own the entire business of S. & G. Gump Company. From March 28, 1905, the date of Mr. Gump's marriage, to February 9, 1929, the date when Mr. Gump sold his stockholdings in the S. & G. Gump Company to his brother, Abraham L. Gump, the decedent and his two brothers devoted their entire time and efforts to the development and building up of the business of S. & G. Gump Company, and the success of that company was largely due, not to the invested capital, but to the ability, hard work and efforts of the decedent and his two brothers. (R. 93-94.)

It is the contention of the petitioners herein, and it was held by the Probate Court of the State of California, in and for the City and County of San Francisco, in the Matter of the Estate of Alfred S. Gump, deceased, that all property of which Mr. Gump died possessed was community property. This is not disputed by the respondent.

Prior to 1923 Section 201 of the Probate Code, formerly Section 1401 of the Civil Code of the State of California, read as follows:

"Upon the death of the husband one-half of the community property *goes to* the surviving wife, and the other half is subject to the testamentary disposition of the husband, and in the

absence of such disposition *goes to* his descendants." (Italics ours.)

In 1923, after the amendment to the foregoing statute, it read as follows:

> "Upon the death of either husband or wife one-half of the community property *belongs to* the surviving spouse. The other half is subject to the testamentary disposition of the decedent, and in the absence thereof goes to the surviving spouse subject to the provisions of Sections 202 and 203 of this Code." (Italics ours.)

It must be conceded that there was some motivating power which caused the Legislature of the State of California, by its voluntary intention and act, to make the foregoing amendment.

This intention, we contend, was to have the half of the community property belong to the wife on death, so as to exempt it from inclusion in the gross estate for Federal estate tax purposes. Her half was already excluded from inheritance tax in the State of California.

In the case of *Talcott v. United States*, 23 Fed. (2d) 897, decided January 30, 1928, the Circuit Court of Appeals for the Ninth Circuit interpreted the sections as they stood at the time of the death of Talcott on December 8, 1919. Before the 1923 amendment of Section 201, the Commissioner of Internal Revenue, on September 20, 1920, made his return including the entire community property as taxable for Federal estate tax purposes. An appeal followed. The main question presented in this case was whether the one-

half interest of the surviving wife in the community property of her deceased husband and herself, where both were domiciled in California, was subject to a Federal estate tax. The Circuit Court of Appeals held that it was, and at page 900 of the opinion we find the following language:

> "Section 1402 of the Civil Code of California provides: 'Upon the death of the husband, one-half of the community property *goes to* the surviving wife, and the other half is subject to the testamentary disposition of the husband, and in the absence of such disposition, goes to his descendants.' The interest of the surviving wife is there placed in the same category with the interest of the heirs and the use of the word 'goes' would seem to contemplate a transfer, both as to the wife and as to the heirs. * * * And in the Stewart Case the court, referring to the act of 1905 as interpreted in the Estate of Moffitt, and to the amendment of the act in the year 1917, which provided that for the purpose of the act 'the one-half of the community property which *goes to* the surviving wife * * * shall not be deemed to pass to her as heir to her husband, but shall, for the purpose of this act, be deemed to go, pass, or be transferred to her for valuable and adequate consideration and her said one-half of the community (property) shall not be subject to the provisions of this act,' said that it was not the purpose of the act of 1917 to change the otherwise general and long-established rule of property except in its application to the particular and limited purpose of said inheritance tax law. Said the court: 'All that the Legislature by these amendments did do or attempt to do was to cast about the interest of the wife in both the real

and personal property of the community during the continued existence of the marriage relation added safeguards and protection against the fraudulent or inconsiderate acts of the husband in the exercise of his control and dominion over these properties of the nature of those already provided for in earlier statutes and especially in and by the 1891 amendment (St. 1891, p. 425) to Section 172 of the Civil Code. * * * We are therefore clearly of the opinion that the amendments to the Civil Code, adopted in 1917 (St. 1917, p. 829) did not operate to change such rule to the extent of creating in the *wife a present vested interest in the property of the community during the continuance of the marriage relation.*' " (Italics ours.)

It is apparent that the Circuit Court attached weight to the transitory very used, to wit, "goes to".

The statute was changed in 1923 to read "belongs to", which is a verb of repose. The legislative intent evidently was to avoid the inclusion of the wife's half, on the theory used by the Commissioner in 1920 in the Talcott case. At the next legislative session in 1923 this change was made, using the words "belongs to" in place of "goes to". Since said amendment the courts have had occasion to be concerned with Section 201, as amended.

In the recent decision rendered May 18, 1940, in the case of *Bank of America National Trust and Savings Association, Trustee and Distributee of the Estate of Parker M. Lewis, Deceased, Plaintiff, v. Nat Rogan, Collector of Internal Revenue for the Sixth Collection District of California, Defendant* (33 Fed. Supp. 183),

Judge Yankwich reviews at length the community property law of California, and points out that upon the husband's death one-half the community property *"belongs"* to the wife, and then says:

> "The question involved is whether Elizabeth Lewis had, at the time of the death of her husband, an undivided one-half interest in the property,—so as to exempt the value of it from his gross estate under Sections 301-303 of the Revenue Act of 1926.
>
> * * * * * * *
>
> The rights of the wife are to be determined by the law of California. Talcott v. United States, 9 Cir., 1928, 23 F. 2d 897; Gillis v. Welch, 9 Cir., 1935, 80 F. 2d 165. If, by this law, at the time of the creation of the trust agreement and, consequently, at the time of Lewis' death, his wife had acquired a 'present, existing and equal interest' California Civil Code, Sec. 161a, then the deficiency was exacted wrongly.
>
> * * * * * * *
>
> Arguments by analogy may help, at times.
>
> But, where the nature of an estate is determined by the law of the State, arguments by analogy from gift cases and other tax cases are of little help.
>
> Ultimately, the nature of the interest of the wife in community property must be determined, not by reference to the federal tax statutes, but in the light of the property law of California. The management and control which the husband has under the law of California, does not defeat the character of the wife's interest as that of a half owner. California Civil Code, Secs. 172, 172a. When property is given its community character

by agreement, it acquires such characteristic the moment the agreement between the spouses is made.

So here, the agreement of February 15, 1932, merely carried into effect the previous understanding, which had existed for many years as to common ownership of the property. By changing the ownership from joint tenancy to community, the amount of Mrs. Lewis' interest was not changed. It remained one-half. Certain incidences characteristic of joint tenancy were surrendered by her. In reality, the character of her estate was debased. She received, in exchange, a half interest which carried certain detriments not attendant upon a joint tenancy interest. But her ownership of one-half, of which she could not be deprived without her consent, remained as absolute as before. Whatever we may call it, it is certainly an interest belonging to the wife, which should not be included in the husband's estate. (Citing cases.)

The decision of the Supreme Court in United States v. Malcolm, 1931, 282 U. S. 792, 51 S. Ct. 184, 75 L. Ed. 714, is very illuminating on this point. The court, in United States v. Robbins, 1926, 269 U. S. 315, 46 S. Ct. 148, 149, 70 L. Ed. 285, had denied to wives in California the right to return half of the earnings of the community property, because 'the wife had a mere expectancy while living with her husband.'

* * * * * * *

If, despite the husband's power of management and control over the community property, California Civil Code, Secs. 172, 172a, during his lifetime, the wife may return, *as her own,* one-half of the income from it, I fail to see why, after his

death, her share, now wholly released of his management or control, should be considered a part of his estate. Her share, upon the husbands death, 'belongs' to her. California Probate Code, Secs. 201, 201.5. How then could it also 'belong' to the husband's estate and be a part of it?

If we give to these codifications their plain meaning, in the light of their legislative history, the answer is obvious:

Whether it meet all the abstract or dogmatic tests of a 'vested' interest or not,—the interest of the wife involves an ownership of her own, definite enough to warrant its exclusion from the husband's estate.

* * * * * * *

This makes it unnecessary to deal with some of the other theoretical and abstract considerations and arguments as to the nature of community property ownership to be found in the writings of taxation experts and some court decisions. By dissecting our community property law and subjecting it to various categorical tests, one could easily pulverize and reduce to naught the interest of the wife, so as to deprive California wives, for taxation purposes, of the benefits which communal ownership confers upon them. We prefer to deal with realities."

In *United States v. Goodyear,* 99 Fed. (2d) page 523, the phraseology of Section 201 of the Probate Code as amended is considered, including the words "belongs to". Goodyear and his wife were married in 1891 and acquired community property before July 29, 1927. They made a contract January 1, 1931, alleging that all of the property was acquired by the

parties previous to July 29, 1927, and conferred all of their property to community property. The court held:

> "In 1923 there was an amendment to the Civil Code, Sec. 1401 (now Sec. 201 of the Probate Code) provided that 'Upon the death of either husband or wife, one-half of the community property belongs to the surviving spouse; the other half is subject to the testamentary disposition of the decedent, and in the absence thereof goes to the surviving spouse' subject to certain exceptions.
>
> On July 29, 1927, Sec. 161a, an amendment to the Civil Code became effective. It provided: 'The respective interests of the husband and wife in community property during continuance of the marriage relation are present, existing and equal interests under the management and control of the husband as is provided in sections 172 and 172a of the Civil Code. This section shall be construed as defining the respective interests and rights of husband and wife in community property. * * *'
>
> After that amendment, litigation ensued over the question as to whether the income of the community could then be divided for income tax purposes. The question was answered in the affirmative on January 19, 1931, in United States v. Malcolm, 282 U. S. 792, 51 S. Ct. 184, 75 L. Ed. 714."

The Circuit Court of Appeals in the instant case refused to decide the question here presented, and the opinion is silent thereon, even though the matter was

raised as one of our questions on appeal, and fully briefed for the Circuit Court's consideration.

It is unquestionably the California law that since the 1923 amendment the wife, by reason of said amendment, is the full and complete owner of the half of the community property upon the husband's death, in that it belongs to her. In fact, during his lifetime and before her death, she is given the right of testamentary disposition of the half.

POINT B.

The Commissioner included in the Federal estate tax return all of the community property, refusing to exclude any portion of the increased increment of the S. & G. Gump Company created between July 29, 1927, and December 31, 1928.

On July 29, 1927, Section 161a of the Civil Code clearly established that from then on the wife had more than a mere expectancy in community property. Her interest is defined by Section 161a, as amended, as follows:

> "The respective interests of the husband and wife in the community property during the continuance of the marriage relationship are present, existing and equal interests under the management and control of the husband, as is provided by Secs. 172 and 172a of the Civil Code. This section shall be construed as defining the respective interests of the husband and wife in community property."

It is provided under Section 302 of the Revenue Act of 1926 that the value of ~~the gross~~ estate of a decedent shall be determined by including the value at the time of death of all property, real or personal, tangible or intangible, to the extent of the interest therein of the decedent at the time of his death. Under the provisions of Civil Code Sec. 161a, the husband has no ownership in, no interest in, and no right in one-half of the community property acquired after July 29, 1927, other than his right to inherit his wife's one-half interest in the community property in the event she does not make other disposition thereof by a last will and testament.

In the very opinion of the Board of Tax Appeals in this case it is stated:

> "It has been repeatedly held that the interest of a surviving wife in community property acquired *prior to* July 29, 1927, is, under the laws of California, no more than a mere expectancy, although her interest may be more definite than that of an ordinary heir." (Italics ours.)

The Circuit Court of Appeals in this case held as follows:

> "It was stipulated that at December 31, 1928 (the date as of which the contract of sale became effective) the earned surplus of the Gump Company attributable to the 2,664 shares held by Alfred S. Gump had increased by the amount of $198,028.44 over the earned surplus attributable to such shares at July 29, 1927. In other words, there was an increase in the book value of the Alfred S. Gump shares by that amount."

It is our contention that one-half of said increased value, to wit, the sum of $99,014.22, should not have been included in the Gross estate return in that it was acquired after the amendment of July 29, 1927, to Sec. 161a of the Civil Code, by virtue of which the wife became vested of a property right in and to one-half of the community property acquired after that date.

It has been, and is, the contention of petitioners that the increment in the value of the stock of S. & G. Gump Company, viz., $198,028.44, for the period between July 29, 1927, and December 31, 1928 (the effective date of the sale) constitutes community property of the unrestricted type, in which Camille R. Gump has a vested and equal present interest with her husband. In California, the courts of this State have given full effect to the rule laid down in *Pereira v. Pereira,* 156 Cal. 1, *Estate of Fellows,* 106 Cal. App. 681, *In re Gold Estate,* 170 Cal. 621, and the decision by the Supreme Court of the State of Washington in *In re Buchanan's Estate,* 154 Pac. 129, to the effect that when a husband had an investment in a business which was either his separate property or community property of the restricted type, and in which business the earnings and increment thereof were largely dependent upon the husband's personal services, that increment was community property of the unrestricted type except as to an interest allowance upon a long term investment well secured. In many of these cases the husband's separate estate, or the community property of the restricted type, was allowed

from 4% to 7% upon the amount of capital invested, and the balance allocated to community property of the unrestricted type.

POINT C.

The Circuit Court of appeals in its opinion holds

> "2. It was stipulated that at December 31, 1928 (the date as of which the contract of sale became effective) the earned surplus of the Gump Company attributable to the 2,664 shares held by Alfred S. Gump had increased by the amount of \$198,028.44 over the earned surplus attributable to such shares at July 29, 1927. In other words, there was an increase in the book value of the Alfred S. Gump shares by that amount." (R. 252.)

It is the contention of the petitioners, as set out in Point B hereinabove, that one-half of the increase in the amount of \$198,028.44 for the period between July 29, 1927, and December 31, 1928 (the effective date of the sale) belongs to Camille R. Gump, and that said sum, to wit, \$99,014.22, should not be included in the Federal estate tax return. It was the result of the activities of Alfred S. Gump, Abraham L. Gump and William E. Gump in devoting their entire time and efforts to the development and building up of the business of S. & G. Gump Company, and the success of the company was due largely to those efforts, including ability and hard work. (R. 93-94.)

The Board of Tax Appeals, as well as the Circuit Court of Appeals, attempts to draw certain inferences. (R. 253.) The opinion reads:

"The question is primarily one of fact, and the record before the Board permitted of the drawing of divers inferences. By 1927 the Gump Company was beyond the pioneer stage; it had long since 'arrived', and Gump's stock had already a book value little short of a million dollars. The years 1927 and 1928 were boom years. In the absence of a clear showing to the contrary, it is inferable that such increment in book value as then took place was largely a normal enhancement of capital investment in a stable and prosperous business. Mr. Gump was at the time over 60 years of age and currently received for his services a salary of $20,000 a year. That his continued participation and the exercise of his talents were not believed essential to the success of the establishment is suggested by the fact that his interest was shortly to be acquired by one of his brothers. The Board was entitled to infer that the salary fully compensated the community for the husband's personal efforts, particularly at that stage in the development of the business. Van Camp v. Van Camp, 53 Cal. App. 17; Shea v. Commissioner, (CCA 9), 81 Fed. 2nd 937."

There is no evidence that the years 1927 and 1928 were boom years. Quite to the contrary, the evidence shows that they were comparatively poor years. (R. 97-98.)

There is further evidence that Alfred S. Gump's efforts, energy and ability contributed to the success attained and the value of his holdings in December, 1928, in that there is included in the contract for the sale of the stock a provision that he shall not indulge in a competitive business. (R. 83.) Had he ceased

to be potent in this character of business, no such provision would have been exacted.

The Court erred in predicating its legal conclusions on inferences attempted to be drawn from evidence which is admittedly contrary to the stipulated facts.

POINT D.

The Board of Tax Appeals and the Circuit Court of Appeals held that in spite of the fact that 74.0458% of each dollar collected on the installment obligations of the face value of $384,994.45 constituted income taxable to the estate when collected, nevertheless the installment obligations were to be valued for estate tax purposes at their fair market value as of the date of death in the sum of $384,994.45. Both decisions held that the same sum can be both corpus and income to the estate and each taxed accordingly.

The decisions are predicated upon a fundamental error, namely, in holding that upon the sale of shares of stock in 1929 (determined by respondent to have been on the installment basis), the entire gain was *then realized* and *taxable to decedent*.

The Circuit Court in its opinion states:

> "In the year the sale was made Gump realized a taxable profit to the extent of the difference between the cost basis of the stock and the amount for which he sold it. The latter amount was made up of the cash received, plus the then value of the promissory note. * * * The whole gain was taxable as income, although by reason of the

installment provisions of Section 44 of the Revenue Act of 1928 the taxpayer was given the option to defer payment until the installments were collected." (R. 254.)

The Board held that under Section 44 of the Revenue Act of 1928 decedent was given an *option* to pay income tax on only a part of the *realized gain,* and that the exercise of the option merely deferred taxation. (R. 38.)

The foregoing opinions do not properly construe the law under the Revenue Act of 1928 or under subsequent revenue acts in respect of installment sales.

The law specifically provides that there is no realization of income in the case of an installment sale except as to that part of the gain included in the installment payment made in cash or the equivalent.

This is evident from the following:

Prior to the Revenue Act of 1926 the only methods of accounting provided by law for the computation of net income were the "cash" and the "accrual" methods.

The Revenue Act of 1926 for the first time provided a third method, i. e., the accounting and determining of net income on the installment basis. This method of accounting was continued in the 1928 and subsequent Acts as Section 44.

As stated in the report of the Senate Finance Committee (69th Congress, 1st Session, St. Rept. 52):

"The revenue act of 1924 and prior acts have specifically provided two bases only for reporting

income—first, cash receipts and disbursements, and, second, accrual. Since the enactment of the revenue act of 1921, however, section 202 (f) and its successors have impliedly *recognized the existence of a third basis, the installment basis,* without in any wise defining the situations and businesses to which such basis might be applied." (Italics supplied.)

After reviewing the fact that the Commissioner had by his regulations authorized the installment basis for reporting income but that recent decisions of the Board had held that such regulations were invalid under the earlier Acts "and that the Commissioner under the law could authorize no basis other than the cash receipts and disbursements basis or the accrual basis, except for certain minor departures," the report of the Senate Finance Committee states that the amendment authorizing the third basis for reporting income, i. e., the installment basis, was proposed in order to meet the situation resulting from the Board decisions and "places the principles of the Commissioner's regulations in the law and thereby validates the regulations for all periods after January 1, 1925."

In the report of the Conference Committee (69th Congress, 1st Sess., H. Rept. 356)—Amendment No. 16, it is stated:

"The Commissioner of Internal Revenue, in pursuance of his authority to accept and define the accounting methods which clearly reflect income, has for a number of years recognized the installment basis of accounting, but prior revenue acts have not defined the transactions or busi-

nesses to which the installment method of computing income might be applied. This amendment writes into the bill the basic principles of the installment method authorized by prior regulations. * * * In the case of casual sales of personal property or of the sale or other casual disposition of real property if in either case the initial payments do not exceed one-fourth of the purchase price, the commissioner with the approval of the Secretary is authorized to make regulations so that the income from such transactions may be returned on the basis and in the manner above prescribed. If the taxpayer chooses, as a matter of settled practice, to treat an entire transaction as completed in the year which the sale is made, it is intended that he shall have a right to make a return for the whole profit realized or to be realized from the entire transaction as income for the year in which the sale is made; and the House recedes with a clarifying amendment."

Further emphasis is given to the fact that the installment basis of reporting income is a method of accounting by the fact that in the 1928 Act specific provision was made (Section 44 (c) for a change from the accrual to the installment basis; and also for situations in which installment obligations are satisfied at other than their face value or distributed, transmitted, sold or otherwise disposed of, it being settled that in such instances there shall be recognizable gain or loss. (Section 44 (d).)

In Paul and Mertens Law of Federal Income Taxation, Volume I, paragraph 12.04, the author in

the text and footnotes under that paragraph covers the subject as follows:

> "The fundamental thought of permitting taxpayers to report on the installment basis is to prevent them from having to pay tax on a profit realized in terms not permitting the payment of tax. It has been said that the provision was a relief provision designed to 'enable a merchant to actually realize the profit arising out of each installment before the tax was paid' so that the tax could be paid 'from proceeds collected rather than be advanced by the taxpayer.'"

Thomas F. Prendergast, Exec., 22 B. T. A., 1259. In footnote No. 32 the author says:

> "There is probably no better statement on this point than that made by Judge Learned Hand in S. & L. Building Corp v. Comm., 60 F. (2d) 719 C. C. A. (2d) 1932) reversed 288 U. S. 406, 77 L. Ed. 861, 55 S. Ct. 428, but still sound as a general statement. Speaking of the 1926 Act provision, Judge Hand said it 'was designed to allow a taxpayer in the case of the installment sales to spread the profit over the whole period during which payments were made, so as to avoid loading all of it upon those years which followed the amortization of the original cost. It gave a privilege; 'the income MAY * * * be returned on the basis and in the manner above prescribed.'"

In *Snell v. Commissioner*, 97 F. (2d) 891 (C. C. A. 5th, 1938) the Court stated:

> "As to the installment sales made in 1923, the taxpayer might have elected to take his whole profit then and have had it taxed under the

Revenue Act of 1921. He chose to *defer realization of the profits* on the deferred installments. These thereby were left to fall under such provisions of the law as might be of force at their maturity. That the law as might be changed, not only in the tax rate but in any other of its provisions, was a risk the taxpayer took *in deferring the realization of his gains.* The Board rightly applied to them the law as it stood when the gains became taxable."

Section 44 is a subsection under Part IV of the Revenue Act of 1928, which is entitled "Accounting Periods and Methods of Accounting"; and Part IV embraces Sections 41 to 48, both inclusive, all of which sections deal with methods of accounting and the period for reporting gross income, deductions and credits under the method of accounting selected by the taxpayer.

The sale of shares of stock which resulted in the receipt of decedent of installment obligations took place in 1929; and the Revenue Act of 1928 is therefore the applicable Act to determine whether or not the entire amount of gain on the sale was then realized by decedent. The law specifically provides that the *entire gain* was *not realized* upon the receipt of the installment obligations in 1929 for the following reasons:

Section 41 provides that net income shall be computed in accordance with the method of accounting regularly employed in keeping the books of the taxpayer, and provides also that if the method employed does not clearly reflect the

income, the computation shall be made in accordance with such method as, in the opinion of the Commissioner, does clearly reflect the income. The Commissioner approved the installment method of accounting used by decedent in 1929 for determining the gain realized in that year upon the sale of shares of stock and the receipt of cash and installment obligations.

The computation of gain in the case of installment sales is covered by Section 44 (a) which provides that a person selling property on the installment plan "may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit *realized or to be realized when payment is completed,* bears to the total contract price."

This is a method provided by law for accounting for realized income. It is *not* (as stated in the Board Opinion) an "option to pay income tax on only a part of the realized gain", and it is *not* (as stated in the Board Opinion) an exercise of an option to defer taxation of realized gain.

Respondent, by his regulations (Article 351 (d) of Regulation 74) has specifically provided that in the case of an installment sale gain is only realized when money or its equivalent is received. Article 351 (d) of Regulations 74 provides:

"Thus the income of a dealer of personal property on the installment plan may be ascertained by taking as income that proportion of the total payments received in the taxable year from installment sales * * * which the total

or gross profit realized or to be realized on the installment sales made during each year bears to the total contract price of all such sales made during that respective year."

(The Regulations provide that in the case of a casual sale income may be determined in a similar manner.)

" * * * If the vendor chooses as a matter of consistent practice to return the income from installment sales on the straight accrual or cash receipts and disbursements basis, such a course is permissible."

Moreover, Section 44 (d) provides that gain or loss *shall result* in the case of a sale or other disposition (including distribution or transmission) of an installment obligation.

How, then can it be contended that the *entire gain is realized* at the time the property is sold, and that the same amount of gain can again *be realized* upon the sale or transmission of installment obligations?

The error of such a conclusion is further emphasized by the fact that Section 44 (d) was amended by the 1934 Act to provide that in the case of distribution, transmission or disposition other than by sale or exchange:

"Any gain or loss so resulting shall be considered as resulting from the *sale or exchange of the property* in respect of which the installment obligation was received;" (Italics supplied.)

and it is further emphasized by the fact that by Section 117 (c) (1) of the Revenue Act of 1934 the

period of holding for computation of capital gain is provided to be the same as *the property* for which the installment obligations were received.

It is to be further noted that under Section 112 the *entire amount* of the gain or loss determined under Section 111 is to be recognized, (subject only to the exceptions provided in Section 112 which are not here pertinent); and that Section 111 is not applicable in the case of the gain resulting from an installment sale except to the extent "of that portion of any installment payment representing gain or profit in the year in which such payment is received". (Section 111 (e).)

It is further to be noted that Sections 42 and 43, appearing for the first time in the Revenue Act of 1934 and relating to the accrual and deductions in the event of the death of a taxpayer, are not applicable to the gain contained in installment obligations, for the reason that Section 44 (d) takes care of such situation.

Added emphasis is given to the conclusion that no gain is deemed to have been realized through the sale of property on the installment basis until the receipt of money or its equivalent, by the fact that Congress recognized the injustice resulting from taxing unrealized gains upon death as provided by the Revenue Act of 1928; and incorporated in the 1932 Act a provision for the filing of bond conditioned upon the returning as income of the amount of the gain when received by the estate or heirs or legatees. That provision reads as follows:

"This subsection shall not apply to the transmission at death of installment obligations if there is filed with the Commissioner, at such time as he may by regulations prescribe, a bond in such amount and with such sureties as he may deem necessary, conditioned upon the return as income, by the persons receiving any payment on such obligations, *of the same proportion of such payment as would be returnable as income by the decedent if he had lived and had received such payment.*" (Italics supplied.)

The petitioners herein filed such a bond in the sum of $25,877.59, which was approved by the respondent.

The Board and Circuit Court opinions are erroneous in holding that the same item can constitute both corpus and income to the estate; and in ignoring the plain language and purport of the decision of the Court of Claims in the case of *Nichols v. United States* 64 Ct. Claims 241; certiorari denied 277 U. S. 584. The Court, in ordering refund of income tax paid, stated that one item cannot be treated as part of the value of the gross estate for estate tax purposes and as part of the gross income of the estate for income tax purposes; and in referring to the estate tax says:

"The tax thus imposed upon the transfer of the estate (Section 401, Revenue Act of 1918) is upon the interest which ceases by reason of the death, and is not upon the interest to which legatees and devisees succeed, (*Y. M. C. A. v. Davis*, 264 U. S. 47, 50, *Edwards v. Slocum*, 264 U. S. 61). An interest thus ceases and the estate interest begins at the time of the death. When, therefore, an item is properly determined

to constitute a part of the gross estate of a decedent for estate tax purposes it cannot by any sort of reasoning be made to constitute a part of the income of the same estate. It is a part of the corpus. The income of an estate which the statute taxes is, generally speaking, the income which accrued after the estate begins * * * It is not to be presumed that Congress intended to subject the corpus of the estate to double taxation (see *Suppellee-Biddle Hardware Co. case,* 265 U. S. 189, 195), though income accruing as such to the estate during administration is taxable as income. The contention of the Government that 'there can be no capital in the estate unless that which constitutes the capital item has first been treated as income, either of the decedent or of the estate', cannot be readily accepted, but when this premise is followed by the admission that the plaintiffs 'correctly argue that there was no income to the decedent' and that, therefore, the distributive share of commissions received from the partnership must be income of the estate, it is manifest that the assumed premise is itself at fault."

The case of *Bull v. United States,* 295 U. S. 247, is to the same effect.

Congress, in granting authority to report for income tax purposes on the installment basis, recognized the injustice resulting from taxing unrealized gains; and accordingly provided for the method of accounting known as the installment method; and the Board of Tax Appeals' opinion is in direct contradition to the congressional intent, which provided that speculative and unrealized gains are not to be recognized until the

receipt of money or its equivalent; and the Board of Tax Appeals' opinion errs in presuming that Congress intended to subject speculative and unrealized gains to double taxation by first subjecting them to estate tax and thereafter subjecting them to income tax.

The Circuit Court of Appeals erred in failing to recognize that by reason of the filing of the bond, in accordance with Section 44 (d), the estate has bound itself and the heirs and the legatees to return as income "the same proportion of any payment on the installment obligations as would be returnable as income by the decedent if he had lived and had received such payments"; and that this obligation, approved by the Commissioner, constituted a contract entered into by petitioner and the Commissioner pursuant to law (Secton 44 (d), whereby petitioner agreed to report income upon collections in a certain manner and the Commissioner agreed to treat and tax the collection as income in the same manner.

The Board and the Circuit Court ignored the contractual relationship which was created between the estate and the respondent by the filing of the bond and the acceptance thereof in determining that the installment obligations are to be valued at their face of $384,994.45. In so doing both decisions hold in effect that there was a realization of income through transmission at death of the installment obligations. *The law says that this does not occur where a bond is filed.* (Section 44 (d).)

The estate has reported as taxable income 74.0458% of each dollar collected; and if the decision of the

Circuit Court of Appeals is allowed to stand, the estate nevertheless will not be allowed to use the value of $384,994.45 as the basis provided by Section 113 (a) (5) (value at date of death) in determining taxable income.

It is to be noted that the entire scheme of taxing income is based upon the method of accounting used by the taxpayer, and not by any theoretical idea of realization of gains. The methods of accounting available to a taxpayer are established by the provisions of Part IV of the Revenue Act of which the installment provisions, Section 44, are a part. The taxpayer in the instant case availed himself during life of such method. Prior to the enactment by Congress of the provisions of Section 44 of the Revenue Act, the Commissioner of Internal Revenue had issued regulations permitting the reporting of installment sales upon practically the same basis as is provided in Section 44, but owing to a decision of the Board of Tax Appeals holding that such permission was without warrant of statute, it became necessary for Congress to enact this into substantive law, and thereupon Section 44 was enacted. The records of the Congressional Committees, both Senate and House, show that the real purpose of enacting Section 44 was to make it unnecessary for a taxpayer to pay a tax upon the contingent profits of an installment sale before he had actually realized the same and collected them and reduced them to possession. If this is not a correct interpretation of the laws, and if, as the opinion states, the entire gain was realized

at the time of sale though the tax payment was deferred, there would have been no necessity for the enactment subsequently of Section 44 (d), which provides in part that upon transmission by death of an installment obligation, the gain is completely realized and immediately taxable to the decedent at the then fair market value. Prior to the enactment of Section 44 (d), numerous decisions of various Circuit Courts of the United States had determined that upon the death of the holder of installment obligations which he was reporting under Section 44, there was no tax to be paid either by him or by his estate for the reason that he had never received as income a taxable gain on the part of the installment contract still unpaid, uncollected and unrealized, and that it could not be income to his estate since they took the installment obligation as capital. In order to obviate this situation, through which a considerable amount of income tax was lost to the government, Congress enacted Section 44 (d). It was stated that the purpose of the enactment of Section 44 (d) was to overcome this difficulty by which large sums of income tax were wholly lost to the government. At the same time the committee determined that this again would impose a hardship upon the estates in requiring them to immediately pay an income tax upon gains from installment contracts neither realized nor collected nor reduced to possession. They therefore enacted as part of Section 44 (d) the proviso which calls for the bond in an amount to be determined by the Commissioner conditioned that the executors, the beneficiaries, or devisees would pay to

the government the tax upon the part of the installment obligation collected which represented gain realized at the time of its collection and reduction to possession. As was said by the chairman of the finance committee, the intent and purpose of the proviso of Section 44 (d) was to place the personal representatives of the decedent, or his heirs and beneficiaries, in precisely the same position as he, the decedent, had been during his lifetime; that the estate stood in his shoes.

The Court states that in the year Gump sold his stock he "realized a taxable profit to the extent of the difference between the cost basis of the stock and the amount of which he sold it"; and the Court states that the amount for which he sold it was made up of the cash received plus the *then* value of the promissory notes.

That the Court erred in its conclusion and in this statement is evidenced by the following:

(A) A "taxable profit" is not "realized" unless the transaction results in a gain *taxable* in the year in which the transaction occurred computed under the Revenue Act then in force.

The sale by Gump of his stock took place in 1929, and whether or not a taxable gain was realized must be determined under the Revenue Act of 1928. That Act provides that in respect of certain transactions (installment sales) the taxpayer "may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized, or to be realized

when payment is completed, bears to the total contract price". (Sec. 44 (a) of the Revenue Act of 1928.)

Note the language in Section 44 (a) quoted above, "gross profit realized *or to be realized*".

A conclusion that the entire gain was realized in 1929 is in express contradiction to the language of the statute, and would make the words "to be realized" meaningless.

And, if further evidence is needed that the entire gain was not realized upon the sale in 1929 one needs only to refer to Section 44 (d) of the 1928 Act, and to similarly numbered sections of the subsequent Acts wherein provision is made for the determination of gain or loss upon the disposition of installment obligations.

That section provides that upon the sale or other disposition of installment obligations gain or loss shall result to the extent of the difference between the basis of the obligation and the amount realized, or in the case of a distribution, transmission or disposition otherwise than by sale or exchange, the difference between the basis of the obligation and the fair market value at the time of such distribution, transmission or disposition; and the law provides that "the basis of the obligation shall be the excess of the face value of the obligation over an amount equal to the income which would be returnable were the obligation satisfied in full."

The Court states that the entire gain was realized in 1929. It, therefore, follows that any gain in excess

of the amount determined in 1929 under the Court's theory *must result from a new and separate transaction,* and did not grow out of the sale of the property in 1929.

Any such theory is not supported by law because it cannot be reconciled with the provision of Section 44 (d) of the Revenue Act of 1934 which provides that in the case of distribution, transmission or disposition other than by sale or exchange,

> "Any gain or loss so resulting shall be considered as resulting from the *sale or exchange of the property* in respect of which the installment obligation was received;" (Italics supplied.)

and by the further fact that by Section 117 (c) (1) of the Revenue Act of 1934 the period of holding for computation of capital gain is provided to be the same as the *property* for which the installment obligations were received.

(B) Furthermore: Prior to the Revenue Act of 1926 the only methods of accounting provided by law for the computation of taxable net income were the "cash" and the "accrual" methods. The Revenue Act of 1926 for the first time provided a third method for determining taxable net income, i. e., the accounting and determining of taxable net income on the installment basis.

(C) A reference to Section 111 of the Revenue Act of 1928, and the similarly numbered sections of subsequent Acts, definitely requires the conclusion that in the case of a sale on the installment plan the gain is only realized when and as collections are made

on the installment obligations; or if no bond is filed then upon transmission at death.

Section 111 (a) of the 1928 Act and the corresponding sections in each of the subsequent Acts contains the general provision that gain is realized from the sale or other disposition of property; and that the amount of the gain shall be the excess of the amount realized over the cost basis; and the subsection (c) defines "amount realized" to be the sum of money received plus the fair market value of property (other than money) received.

But we find in subsection (e) of Section 111 of that Act and in corresponding subsections of the subsequent Acts an exception to the general rule provided in Section 111 (a) and (c), that gain is realized to the extent of the money received and the fair market value of property (other than money) received; and a limitation to the computation of gain or loss as provided by Section 111 (a) in the case of installment sales. Subsection (e) of Section 111 reads as follows:

> "(e) Installment sales.—Nothing in this section shall be construed to prevent (in the case of property sold under contract providing for payment in installments) the taxation of that portion of any installment payment representing gain or profit in the year in which such payment is received."

By virtue of Section 44 (a) providing for the return as income of the proportion of installment payments received; and Section 44 (d) providing for determination of gain upon disposition of installment

obligations; and Section 111 (e) providing for the taxation of the proportion of installment sales, there is no escape from the conclusion that no amount of gain was realized in the year of sale except to the extent of a proportionate part of the cash actually received in the year of sale.

(D) The Court states that "the whole gain was taxable as income, although by reason of the installment provisions of Section 44 of the Revenue Act of 1928 the taxpayer was given the option to defer payment until the installments were collected".

In the above quotation the Court speaks of the "whole gain". We take it that this can only mean the amount of the gain determined as set forth in the second sentence in the same paragraph, viz., that the amount of the gain is to be determined on the basis that the sales price was the cash received plus the *then* value of the promissory notes; and we must assume that the Court meant that it is the tax on the amount of the gain thus determined on which the taxpayer was given the option to defer payment.

It is submitted that the Court is in error in stating that a taxpayer selling on the installment basis was given an option of deferring payment of tax on a realized gain. As set forth above, the law provided a third method of accounting in the case of installment sales. It is submitted that the adoption of this third method of accounting is no more an option to defer payment of tax than is the adoption of either the "cash" or the "accrual" method of accounting by any taxpayer.

The question as to when income is realized in the case of installment sales called for a decision by the Treasury Department as early as 1919 following the regulations authorizing taxpayers to report on the installment basis. See T.D.R. 24, Cumulative Bulletin No. 1, April-December, 1919, page 73, wherein the Advisory Tax Board set out the form of balance sheet to be shown in the income tax returns of taxpayers making returns on the installment basis, and the method of keeping accounts in respect of installment sales and the "unrealized gross profits" and the "realized gross profits" on installment sales.

On page 73 in the cited Cumulative Bulletin there is shown as a "deferred credit item" the item of "unrealized gross profits upon installment sales contracts"; and in the instructions as to the method of treating this item on the books of account of the taxpayer the following are given as the instructions:

> "(d) *Unrealized gross profits on installment sales contracts,* which will be credited with the amount of unrealized gross profit upon the outstanding installment sales contracts at the beginning of the year and with the amount of such unrealized gross profit upon installment sales contracts made during the year. This amount will be computed upon the basis of the total installment sales contracts reduced by the cost or inventory value of the goods covered by the contracts, the remaining balance being the amount of the unrealized gross profit.
>
> "(e) *Realized profits on installment sales contracts,* which will be credited from month to month, or at least at the end of the year, with the

profits realized by collection upon installment sales contracts. Such profits should be computed by taking the same percentage of the total cash collections upon installment sales contracts during the period as the total unrealized profits on installment sales contracts bears to the total installment sales during the same year. Corresponding debits should be made to unrealized gross profits on installment sales contracts. Any necessary corrections to produce a more accurate result can be made as at the end of the fiscal year."

O.D. 623, Cumulative Bulletin No. 3, July-December, 1920, page 105, modified T.D.R. 24, supra, but does not change the requirement that the taxpayer distinguish between "realized profits on installment sales contracts" and "unrealized gross profits on installment sales contracts".

Thereafter there arose the question as to whether the "unrealized gross profits on installment sales contracts" could be included in invested capital for the computation of the excess-profits and war-profits tax imposed by the Revenue Acts of 1917 and 1918; and I.T. 1391, Cumulative Bulletin 1-2, page 240, was published and refers to O.D. 623, supra, and requires that there should be eliminated from inventory the cost of goods sold on installment contracts, and that there be substituted therefor in the balance sheet the value of the installment sales contracts less the "unrealized gross profits", which amount so determined "equals the value of goods sold and is substituted therefor".

The term "invested capital" under the excess-profits and war-profits tax acts of 1917, 1918 and 1921 pro-

vided for the inclusion as part of invested capital of the amount of the earned surplus and undivided profits of a corporation "not including surplus and undivided profits earned during the year".

The question thereupon arose as to whether "unrealized profits on installment sales" could be included in invested capital; and the Treasury, and subsequently the Courts, held that no part of the "unrealized profits on installment sales" as at the beginning of the taxable year constituted an earning of the corporation so as to permit its inclusion as earned surplus or undivided profits, and so to be included in invested capital.

Jacob Bros. Company, Petitioner, v. Commissioner of Internal Revenue, Respondent, 50 Fed. (2d) 394;

Tull & Gibbs, Inc., a Corporation, Appellant, v. United States of America, Appellee, 48 Fed. (2d) 148;

John M. Brant Company v. United States, 69 Court of Claims 516, 40 Fed. (2d) 126;

Schmoller & Mueller Piano Co. v. United States, 67 Court of Claims 428.

If the decision of the Circuit Court is allowed to stand the effect will be that unrealized gains in installment obligations will be included in invested capital under the present law as a basis for credit in excess-profit taxes and result in a loss to the Treasury of many millions of dollars annually in excess-profits tax.

In a volume on "Excess-Profits and Other Federal Taxes on Corporations—1941-1942", Robert H. Montgomery, well-known author and authority on taxation, states (page 186):

> "A reserve for unrealized gross profits on installment sales is not includible in invested capital since it represents gain which has not been recognized. (Section 30.718-2 (a) Regulations 109; *Blum's, Inc.,* 7 B. T. A. 737; and particularly Section 19.115-3, Regulations 103, as amended by T.D. 5059, 1941-28-10,778.)"

The Court in holding that the installment notes at date of death of Alfred S. Gump were taxable at their fair market value as of that date bases its decision on Section 302 of the 1926 Act, as amended by Section 404 of the 1934 Act, c. 277, 48 Stat. 680, 26 U. S. C. A., Section 411, and quotes therefrom as follows:

> "The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated."

It is respectfully pointed out that the above quoted part of Section 302 leaves out an important part of the applicable law; and the meaning of Section 302, when applied to the instant case, is brought into sharp focus when subsection (a) of Section 302 is read in connection with the above quoted part of Section 302. The section when so read states that "the value of the gross estate shall be determined by including the value of all property, * * *"

> "(a) To the extent of the interest therein of the decedent at the time of his death."

Now, what was the interest of decedent in the unrealized profits in the installment obligations? His interest at the time of his death was the right to receive payments made on the installment obligations when and as made, and to report as income the proportion of the profits included in each collection, and to pay tax thereon in accordance with the law in force at the time of the collection. This right to receive and report as income, and pay tax on the profits, was what passed by transmission from decedent; and the filing of the bond by the executor, in accordance with Section 44 (d) of the Revenue Act of 1934, put the estate in exactly the same position as decedent had been in respect of the profits included in such installment obligations.

The Commissioner in his determination of the value of the gross estate did not determine such value by measuring the value of the right to receive future income which passed from decedent at death; and at no time in this proceeding has the Commissioner contended or urged that this was the basis of the measurement for federal estate taxes of the value of the installment obligations. This is the exact situation in the case of *Bull v. United States,* 295 U. S. 247.

In that case there was no attempt at valuation as of death of the contractual right to share in the profits of the partnership. In that case, as here, the Commissioner collected estate taxes on the same item which he later determined constituted income to the estate. The United States Supreme Court reversed and held against the Commissioner.

As stated in the case of *Edmonds v. Commissioner* (1937), 90 Fed. (2d) 14, the Court in distinguishing the facts in that case from the *Bull* case, supra, stated:

> "*Bull v. United States,* supra, refers to cases where the profit is included as both corpus and income of one estate, and not to cases where the profit is included as corpus in one estate and as income to a different person;"

and again in referring to the *Bull* case, stated:

> "The taxes were there paid by the petitioner in the same representative capacity, and a recoupment was allowed. He, petitioner, paid a tax in one representative capacity, and paid another tax in another representative capacity."

In the *Bull* case the receipt of the income of the partnership after death was contingent upon continuance of the partnership and the earnings or profits. In the *Gump* case the realization of the profits included in the installment obligations was contingent upon payments by the debtor.

In the *Bull* case the Court found that there was a "mere right of continuance of the partnership relationship inuring to Bull's estate", and that, "by the terms of the agreements his estate was to sustain precisely the same *status quoad* the firm as he had in respect of profits and losses"; also that under the stipulation the survivors were "in the same relation with the deceased partner's estate as if it were in fact the decedent himself still alive and a member of the firm".

This is the exact situation in the Gump case. No part of the gain, totalling $285,002.22, included in the

face of the installment obligations of $384,994.45 had been realized prior to death; and it was not realized upon death by reason of the filing of the bond, by virtue of which Section 44 (d) deferred realization of the gain until collection by the estate; and thereupon the Gump estate occupied the same relation with respect to the installment obligations as decedent himself had occupied. This *status quoad* is provided by the last sentence of Section 44 (d) of the Revenue Act of 1934, reading as follows:

> "This subsection shall not apply to the transmission at death of installment obligations if there is filed with the Commissioner, at such time as he may by regulation prescribe, a bond in such amount and with such sureties as he may deem necessary, conditioned upon the return as income, by the person receiving any payment on such obligations, of the same proportion of such payment as would be returnable as income by the decedent if he had lived and had received such payment."

The Circuit Court in its opinion did not refer to the case of *Nichols v. United States,* 64 Court of Claims 241, which we cited and in which the Court of Claims expressly held that there could not be both an estate tax and an income tax upon income earned or realized by the estate after the death of decedent.

In the case of *Helvering v. Smith,* 90 Fed. (2d) 590, the Court points out that:

> "It is, of course, possible to measure the purchase price of a partner's interest by his former proportion of future profits for a period of years",

citing

Hill v. Commissioner, 38 Fed. (2d) 165, and
Bull v. United States, supra.

In the case of *Degener v. Anderson,* 77 Fed. (2d) 859, interpreting a partnership agreement providing for continuance of the partnership to the end of the year, notwithstanding the death of the partner (holding the estate of the deceased was taxable upon the income received under such contract) the Court stated:

> "The *Bull* case in line with earlier decisions in the lower courts, recognized that there is a distinction between measuring the value of a contract right which accrued for the decedent at the date of death and taxing income which arises in the future by reason of the contract."

As stated above, the Commissioner at no time in this proceeding has measured the value of the interest of decedent in the unrealized profits included in the installment obligations. He has merely included in the gross estate the value of the obligations themselves.

POINT E.

The Circuit Court of Appeals held that though the unrealized gains upon the installment obligations transmitted by death of the holder thereof were subject to income tax to be paid by his estate, nevertheless the unrealized gains should be included in gross estate for Federal estate tax purposes. This decision is contrary to the law as established in *Bull v. United States,*

295 U. S. 247, 79 L. Ed. 1421, and *Nichols v. United States,* 64 Court of Claims 241.

In the latter case, in determining the Federal estate tax imposed upon the transfer of the net estate of the decedent, the sum of $78,322.36 was included as part of the gross assets. The books of account of the decedent and the books of account of the executors of the estate were kept on a cash receipt and disbursement basis. The executors were required by the Commissioner of Internal Revenue to include as income of the estate said sum of $78,322.36, and to pay a tax thereon. Here we see that the same sum was returned by the Commissioner for both income tax and Federal estate tax purposes. The Court said:

> "It thus appears that one item has been treated as part of the gross estate for estate tax purposes, and as a part of the gross income of the estate for income tax purposes, and the question for decision is whether it can be made to serve in both these capacities. We think the answer must be in the negative. For taxation purposes, the individual's income during his lifetime, and the income of his estate after his death, are distinct things, the individual and his estate being separate entities. * * * When therefore an item is properly determined to constitute a part of the gross estate of a decedent for estate tax purposes, it cannot by any sort of reasoning be made to constitute a part of the income of the same estate. It is a part of the corpus * * *. It is not to be presumed that Congress intended to subject the corpus of the estate to double taxation." (Certiorari denied, 277 U. S. 584.)

POINT F.

The decisions of the Circuit Court of Appeals and the Board of Tax Appeals hold that the unrealized gains included in the installment obligations are taxable as part of the gross estate. Both decisions find that respondent had determined that the estate of the decedent and the beneficiaries thereof must return as income and pay income tax on 74.0458% of the amount collected on the installment obligations, and that respondent has refused to treat the payments when collected as payments on principal applicable to the principal obligation of $384,994.45, and the decisions further find as a fact that the tax on the profit included in the installment obligations would have been $25,877.59 if included in the income of decedent for the period from January 1 to date of death, January 23, 1934.

It is evident therefore that the decisions hold that respondent is treating the profits received by the estate as taxable income for income tax purposes and also as capital of the estate for estate tax purposes. The opinion states that the case of *Bull v. United States*, 294 U. S. 247, is distinguishable on the facts because there the profits subjected both to income and estate taxes were profits earned after the death of the decedent.

The profits were not realized by petitioners' decedent prior to his death, as fully set out in the discussion in the preceding paragraphs, and the *Bull* case is directly in point if the installment obligations

are to be valued at their face value for estate tax purposes.

Section 44 (d) especially provides that upon filing of a bond that that part of the section relating to the realization of income by reason of transmission of installment obligations is not applicable; and the findings of fact show that respondent has determined that when collections on the installment obligations are made they constitute taxable income to the estate; and that respondent has refused to treat the payments as payments of principal applicable to the principal obligation.

The bond filed guarantees the payment by the estate or the beneficiaries of the income tax and respondent determined that the income tax liability so to be guaranteed was $25,877.59 and the statement in the Board opinion that the claim is for credit for taxes which the estate never paid or intended to pay because a bond was filed, is definitely error and such error is due to failure to recognize that the requirements of the bond constituted *an agreement* on the part of the estate to pay the income tax when and as the gain on the installment obligations was realized.

The credit here claimed by petitioners is the "offset" recognized by the United States Supreme Court in *Bull v. United States*, supra, as properly allowable where the Commissioner attempts to tax the same item as corpus and also as income.

The case of *Edmonds v. Commissioner* (1937), 90 F. (2d) 14, supports petitioners' contention. The

Court in the *Edmonds* case, supra, in distinguishing the facts in that case from the *Bull* case, supra, states:

> "*Bull v. United States,* supra, refers to cases where the profit is included as both corpus and income of one estate, and not to cases where the profit is included as corpus in one and as income to a different person";

and again in referring to the *Bull* case, states:

> "The taxes were there paid by the petitioner in the same representative capacity, and a recoupment was allowed. Here, petitioner paid a tax in one representative capacity and paid another tax in another representative capacity."

The Court in the *Edmonds* case does not deny the authority of the Board of Tax Appeals to allow a set-off, and on this question states:

> "Assuming but not holding that the Board would have power to allow a setoff, and that the tax paid by petitioner for the husband's estate was illegal, the right of recovery back thereof would be a right of petitioner as a representative of the husband's estate, and not as a representative of the wife's estate. No set-off could therefore be allowed."

In the case of petitioners herein respondent has stipulated (last paragraph of Stipulation No. 1, page 72 of the Record) that the income tax payable on the income of petitioners' decedent for the period January 1 to January 23, 1934 would have been \$25,877.59 had no bond been filed under Section 44 (d) deferring the reporting and payment of gain included in the installment obligations.

Petitioners concede that the amount of income tax which the estate or the beneficiaries thereof will have to pay on such gain may not be the exact figure of \$25,877.59, but submit that this amount must be accepted and used in determining the "offset" or "credit" for the following reasons:

(a) The Board takes judicial notice that the rates of taxation under the Acts subsequent to the Act of 1934 are higher than in that Act; and that such higher rates are those required to be paid by the estate and the beneficaries thereof on the collections made on the installment obligations;

(b) That the Acts subsequent to the Revenue Act of 1934 have limited or totally disallowed deductions for losses.

It is apparent that the figure of \$25,877.59 is in all likelihood the minimum tax that will be required to be paid by the estate and by the beneficiaries thereof.

In the case of *Burnet, Commissioner of Internal Revenue v. Logan,* 51 S. Ct. 550, the Court in referring to the valuation of a contract states:

> "Some valuation—speculative or otherwise—was necessary in order to close the estate."

It is submitted that the Board should have, as the Supreme Court did in that case, determine an amount properly allowable as an offset or credit to the estate tax as and for the income tax which will be required to be paid, even though the amount is not determinable with absolute accuracy, but where it is reasonably correct.

In further support of the right to this credit or recoupment, reference is again made to the case of *Burnet v. Logan,* supra. That case involved the question as to whether taxable income was realized from the receipts of payments under a contract prior to the time when taxpayer recovered the full amount at which the contract had been valued for estate tax purposes. On this issue the Supreme Court states:

> "In order to determine whether there has been gain or loss, and the amount of the gain, if any, we must withdraw from gross proceeds an amount sufficient to restore the capital value that existed at the commencement of the period under consideration. * * * The statute definitely excepts bequests from receipts which go to make up taxable income."

If the decision that the installment obligations of Abraham L. Gump are to be valued at the face of $384,994.45 is upheld, petitioners will be denied the use of this figure for income tax purposes in respect of 74.0458% of the collections made on the installment obligations; and cannot have the benefit of the Supreme Court's decision as determined by the case of *Burnet v. Logan,* supra, because of the specific provisions of Section 44 (d) of the Revenue Act of 1934. It is submitted that if the Board's decision that the said installment obligations are to be valued for Federal estate tax purposes at $384,994.45 is upheld, that then in equity petitioners are entitled to a credit of not less than $25,877.59 against the Federal estate tax as finally determined.

In denying to petitioners an offset against the estate tax (determined by including in gross estate the full face value of the installment obligations) the sum of $25,877.59, the Court states that the *Bull* case, supra, affords no recognizable analogy for the reason that "there the profits subjected both to income and estate taxes were profits earned after the death of the decedent".

It is submitted that it has been conclusively shown that no part of the gains included in the installment obligations had been realized prior to death or were realized through transmission at death; and it therefore follows that the Court erred in concluding that these gains were earned or realized by decedent; and in failing to determine that they constituted profits of the estate taxable as income to the estate, and that they constituted, as stated in the *Bull* case, supra, "The identical money—not a right to receive the amount, on the one hand, and actual receipt resulting from that right, on the other, * * *".

In the *Bull* case, supra, the Supreme Court held that the Government had erred in the valuation of the gross estate through the inclusion as part of the gross estate of that which constituted income to the estate, and stated:

> "The United States through a palpable mistake took more than it was entitled to. Retention of the money was against morality and conscience";

and concludes:

> "We are of the opinion that the petitioner was entitled to have credited against the deficiency of income tax the amount of his overpayment of estate tax with interest, and that he should have been given judgment accordingly."

This action of the Court was based upon the pleadings by taxpayer claiming the right of recoupment even though the statute of limitation against the refund of estate tax had run.

It is petitioners' contention here that the Commissioner erred in including in his valuation of the installment obligations the unrealized gains thereon; but that if this Court holds that the valuation so determined by the Commissioner is correct, then petitioners claim that they are entitled to an offset against the estate tax of the amount of $25,877.59 income tax under the law enunciated in the *Bull* case. The Circuit Court in the instant case states:

> "Had Gump retained the stock instead of selling it nobody could question that for estate tax purposes it would be valued at its market value at date of death rather than at its cost basis to the decedent."

This is conceded, but in such event the estate upon sale for the same valuation as is included in the measure of the gross estate would have had no gain subject to income tax, and would have had the benefit of Section 113 (a) (5) of the Revenue Act of 1934 and subsequent revenue acts, for the purpose of determining gain or loss, i. e., value at date of death. In

the Gump case the benefit of Section 113 (a) (5) is denied to the estate either as to collections on the installment obligations or upon sale by the estate of the installment obligations, and the estate is required to use the same basis as decedent would have had had he lived and made such collections or effected such sale. In other words, the basis to the estate for gain or loss is \$99,992.23, and not \$384,994.45, the value sought by the Commissioner to be included in gross estate for estate tax purposes.

CONCLUSION.

Wherefore, petitioners, for the foregoing reasons, respectfully pray that a writ of certiorari issue out of this Honorable Court to the United States Circuit Court of Appeals for the Ninth Circuit, commanding that Court to certify and send to this Court, for its review and determination, a full and complete transcript of the record and all proceedings in the case numbered and entitled upon its docket, "No. 9825, Camille R. Gump, Executrix, Edwin Letts Oliver, Executor of the Estate of Alfred S. Gump, Deceased, Petitioners, v. Commissioner of Internal Revenue, Respondent".

Dated, San Francisco, California,
April 27, 1942.

Respectfully submitted,

Chellis M. Carpenter,
Charles A. Christin,
Walter Christie,
Counsel for Petitioners.

INDEX

CITATIONS

462024—42

In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 1192

CAMILLE R. GUMP, EXECUTRIX, EDWIN LETTS OLIVER, EXECUTOR OF THE ESTATE OF ALFRED S. GUMP, DECEASED, PETITIONERS

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 25-43) is reported in 42 B. T. A. 197. The opinion of the Circuit Court of Appeals for the Ninth Circuit (R. 248-256) is reported in 124 F. (2d) 540.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered December 31, 1941 (R. 257). A petition for a rehearing was denied February 3, 1942 (R. 258). The petition for a writ of certiorari

was filed April 29, 1942. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the court below erred in approving the Board's holding that the entire community estate, acquired prior to July 29, 1927, must be included in the gross estate of the husband under Section 302 of the Revenue Act of 1926.

2. Whether the court below erred in approving the Board's holding that the full value, as of the date of death, of unpaid installment notes owned by the decedent must be included in his gross estate.

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1926, c. 27, 44 Stat. 9:

> SEC. 302 [as amended by Sec. 404 of the Revenue Act of 1934, c. 277, 48 Stat. 680]. The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property situated outside the United States. * * *
>
> * * * * *
>
> SEC. 303. For the purpose of the tax the value of the net estate shall be determined—
>
> (a) In the case of a resident, by deducting from the value of the gross estate—

(1) Such amounts for funeral expenses, administration expenses, claims against the estate, unpaid mortgages upon, or any indebtedness in respect to, property (except, in the case of a resident decedent, where such property is not situated in the United States), to the extent that such claims, mortgages, or indebtedness were incurred or contracted bona fide and for an adequate and full consideration in money or money's worth, * * * but not including any income taxes upon income received after the death of the decedent, or any estate, succession, legacy, or inheritance taxes;

* * * * *

Treasury Regulations 80 (1934 Ed.):

Art. 13. *Valuations.*—(1) *General.*—The value of all property includible in the gross estate is the fair market value thereof at the time of decedent's death. The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell. * * *

* * * * *

(5) *Notes, secured and unsecured.*—The value of notes, whether secured or unsecured, will be presumed to be the amount of unpaid principal, plus accrued interest to the date of decedent's death, unless the executor establishes a lower value, or it is shown that they are worthless. * * *

STATEMENT

The petitioners are the executors of the estate of Alfred S. Gump, who died testate on January 23, 1934 (R. 27). Decedent was married on March 28, 1905, and until his death, he and his wife were continuously domiciled in California (R. 27).

The petitioners filed a federal estate tax return in which they disclosed community property of a total value of $799,269.41; but they eliminated one-half as representing the community interest of the widow, leaving a gross estate of $399,634.71. At the time of filing the return, petitioners paid a federal estate tax in the amount of $12,554.86 (R. 27).

Among the assets of the community shown in the estate tax return, there was included the following item: "Payments due under contract between Alfred S. Gump, Abraham L. Gump and William E. Gump—$384,994.45" (R. 27–28).

The S. & G. Gump Company was organized about 1899. On March 28, 1905, the date of decedent's marriage, the decedent owned 25 shares of the capital stock of the Gump Company, which had a book value of $41,636. During the period from the date of his marriage in 1905 to February 9, 1929, the decedent and his brothers, Abraham L. and William E., devoted their entire time and efforts to the developing and building up of the business of the Gump Company, and the success of that company was largely due, and in equal

measure, to the ability and efforts of decedent and his brothers. From March 17, 1921, to February 9, 1929, the decedent held 2,664 shares of common stock of the Gump Company (R. 28).

The decedent and his wife entered into two agreements with Abraham L. Gump, as of February 9 and December 23, 1929. Pursuant to the terms of these agreements, the decedent and his wife sold to Abraham L. Gump 2,710 shares (46 shares of which belonged to his wife) of the common stock of the Gump Company for the book value thereof, or $1,100,976.25, and 15 shares of the capital stock of an affiliated realty company for $84,018.20, or a total of $1,184,994.45. The purchase price was payable to decedent as follows: $500,000 in cash on February 9, 1929 ($84,018.20 of which was in payment of the 15 shares of the realty company), the remaining $684,994.45 in seven annual installments. The liability for these installments was evidenced by a series of notes, six for $100,000 each, and one for $84,994.45, all of which bore interest at 5% per annum. The first note was payable on February 1, 1930, and the last note, of $84,994.45, on February 1, 1936. The notes were all made payable to the decedent and were endorsed by William E. Gump. It was stated in the agreements that the decedent was the owner of 2,664 shares of the Gump Company and the 15 shares of the realty company and that his wife was the owner of 46

shares of the Gump Company (R. 29). Separate accounting for the latter shares was ordered (R. 30).

At the date of the death of decedent, there had been paid under the above contracts the total amount of $800,000, and four notes remained unpaid in the principal amount of $384,994.45 (R. 29).

In auditing the estate tax return filed by taxpayers, the Commissioner determined that the gross estate of decedent consisted of the entire community estate of decedent and his wife, having a value of $802,737.41, and in computing that value he included in the gross estate the four notes unpaid at the death of decedent at their face value of $384,994.45 (R. 30–31).

The taxpayers filed an income tax return for decedent covering the period from January 1 to January 23, 1934. The taxpayers, not desiring to include in such return the gain realized by the transmission of the unpaid installment obligations of Abraham L. Gump by reason of the death of decedent, as provided for in Section 44 (d) of the Revenue Act of 1934,[1] filed a bond at the time of filing the income tax return, conditioned upon

[1] Section 44 (d) provides:

(d) GAIN OR LOSS UPON DISPOSITION OF INSTALLMENT OBLIGATIONS.—If an installment obligation is satisfied at other than its face value or distributed, transmitted, sold, or otherwise disposed of, gain or loss shall result to the extent of the difference between the basis of the obligation and (1) in the

the return as income by all persons receiving any payments in satisfaction of the installment obligations in the same proportion of such payments as would be returnable as income by the decedent if he had lived and had received such payments. This bond was accepted and approved by the Commissioner (R. 31).

The Commissioner determined that 74.0458% of each dollar collected on such installment obligations represented taxable income to be accounted for when collected. He further determined that the estate of decedent and the beneficiaries thereof should return as income and pay income tax on the amount of gain, i. e., 74.0458% of the amounts paid by Abraham L. Gump since January 23, 1934 (R. 31-32).

---

case of satisfaction at other than face value or a sale or exchange—the amount realized, or (2) in case of a distribution, transmission, or disposition otherwise than by sale or exchange—the fair market value of the obligation at the time of such distribution, transmission, or disposition. Any gain or loss so resulting shall be considered as resulting from the sale or exchange of the property in respect of which the installment obligation was received. The basis of the obligation shall be the excess of the face value of the obligation over an amount equal to the income which would be returnable were the obligation satisfied in full. This subsection shall not apply to the transmission at death of installment obligations if there is filed with the Commissioner, at such time as he may by regulation prescribe, a bond in such amount and with such sureties as he may deem necessary, conditioned upon the return as income, by the person receiving any payment on such obligations, of the same proportion of such payment as would be returnable as income by the decedent if he had lived and had received such payment.

The amount of federal income tax that would have been payable on the income of decedent for the period of January 1 to January 23, 1934, would have been $25,877.59 had there been reported as taxable income for that period the amount of gain, or $285,072.22, included in the principal of the unpaid installment obligations in question (R. 32).

The Board of Tax Appeals concluded (R. 37) that, so far as the record shows, the entire estate of the deceased husband was community property acquired prior to July 29, 1927, in which the rights of the wife were so restricted as to require the entire estate to be subjected to the federal estate tax. The Board further concluded (R. 41) that the full value, as of the date of death, of the four installment notes must be included in the gross estate. The court below affirmed (R. 257).

ARGUMENT

Two principal questions are here presented: (1) whether all, rather than one-half, of the community property should have been included in the decedent's gross estate; and (2) whether the value of the four unpaid notes outstanding at the time of decedent's death were part of his gross estate. We submit that the decision of the court below on both these questions is correct, and is not in conflict with any decisions of the Federal or California courts.

1. The California Community Property Law was radically changed in 1927 so as to give the wife certain "vested" rights (compare *United States* v. *Robbins*, 269 U. S. 315, with *United States* v. *Malcolm*, 282 U. S. 792), and it is plain that the community property acquired by the decedent up to the time of the 1927 amendment was taxable in full as part of his gross estate. The petitioners contend, however, that the increase in value of that property between the date of the 1927 amendment and the date of sale in 1929 became vested equally in both spouses under the new California law, and that one-half of that increase was therefore not part of the husband's gross estate. It does not appear to be disputed that under the California decisions the wife would be entitled to one-half the increment if it were attributable to the personal efforts of the husband, but not if it were mere enhancement of capital investment. In this case the property consisted of stock in a corporation, which by 1927 had become an established business; and the increase in value of the stock during the period 1927–1929 was merely a natural enhancement in a prosperous era. It was entirely reasonable to suppose that the decedent's $20,000 salary fully compensated him for his personal efforts. Upon the basis of these facts, the court below correctly concluded that the Board's decision was supported by *Van Camp* v. *Van Camp*, 53 Cal. App.

17, and *Shea* v. *Commissioner,* 81 F. (2d) 937 (C. C. A. 9th), and that decisions such as *Pereira* v. *Pereira,* 156 Cal. 1 (relied upon by petitioners), were distinguishable.

The petitioners also contend here (Br. 16–25) that the court below erred in failing to determine the effect of the 1923 amendment to the Community Property Law of California. Such a contention presents no basis for the issuance of the writ. In the first place, the point was not properly before the court below. The original petition to the Board of Tax Appeals (R. 10) made specific reference only to the 1927 amendment. The assignments of error in the petition for review filed with the court below (R. 53–55) made no specific reference to this contention. In any event, even if the point had been properly presented and even if the 1923 amendment had the effect which the taxpayers contend, the same factual situation would also bar relief. Moreover, it may be observed that the 1923 amendment has been considered ineffective to change the basic nature of the community property holdings for federal tax purposes. *Hirsch* v. *United States,* 62 F. (2d) 128 (C. C. A. 9th), certiorari denied, 289 U. S. 735. See also *Talcott* v. *United States,* 23 F. (2d) 897 (C. C. A. 9th), certiorari denied, 277 U. S. 604.[2]

---

[2] Cases such as *Bank of America Nat. Trust & Savings Ass'n* v. *Rogan,* 33 F. Supp. 183 (S. D. Cal.), and *United States* v. *Goodyear,* 99 F. (2d) 523 (C. C. A. 9th), relied

2. The four installment notes were properly included in decedent's gross estate. Section 302 of the Revenue Act of 1926, *supra*, provides that "the value at the time of his death of all property" shall be included in the gross estate of the decedent; and it is not disputed here that the four notes were worth their face amount of $384,994.45.

Petitioners seek to avoid the unambiguous provisions of Section 302 by contending that approximately three-fourths of the value of the notes constituted "unrealized" gain which would be subjected to income tax when the notes were subsequently paid, and that only the remaining one-fourth of the value of the notes should be included in the gross estate. But there is nothing in the estate tax statute which requires the exclusion of the decedent's property from his gross estate merely because it represents "unrealized" profit. To the contrary, Section 302 requires that the decedent's property be included at its then value. It is immaterial that the cost of the property to the decedent may have been much less than its value at the date of death, and that the difference has not yet been subjected to income tax. Morever, in this case, the installment notes represented gain which was realized in 1929 upon

upon by the taxpayers here (Br. 20, 23) are clearly distinguishable in that the parties there, by specific agreement subsequent to the 1927 amendment, changed the status of property which was concededly restricted under the California law prior to the 1927 amendment.

the sale of the stock, but taxation of that gain was merely *deferred* by reason of the option afforded to the seller under the installment sales provisions of the revenue laws. *Nuckolls* v. *United States*, 76 F. (2d) 357 (C. C. A. 10th); *Crane* v. *Helvering*, 76 F. (2d) 99 (C. C. A. 2d).

Finally, petitioners contend in the alternative that, if the installment notes are to be included in the gross estate at their full value (Br. 62), "then in equity petitioners are entitled to a credit of not less than \$25,877.59 against the Federal estate tax," which figure is the amount of income tax they would have paid if the installments had been accrued as of the date of death. The court below properly pointed out (R. 255) that there was no statutory authority for such a credit. On this point, petitioners rely primarily upon *Bull* v. *United States*, 295 U. S. 247. However, that case involved unique facts, clearly distinguishable from the facts of the case at bar. The tax there in question had been assessed and paid and the right of recoupment under the special circumstances developed was the main issue before the Court. The profits there involved were profits realized by the estate after the death of the decedent, and not, as here, profits realized by the decedent prior to his death. This Court pointed out in the *Bull* case that the identical money—not a right to receive the amount on the one hand and the actual receipt resulting from that right on

the other—was the basis of the two inconsistent assessments. In *Helvering* v. *Enright,* 312 U. S. 636, 641, this Court, in a footnote referring to the *Bull* decision, pointed out that there might well be in some instances a direct relationship between items of income to the estate and items included in the corpus of the estate through valuation of a specific right to receive such income.

CONCLUSION

The court below correctly applied generally accepted principles to the facts of this particular case. There is no conflict of decisions. The petition should be denied.

Respectfully submitted.

CHARLES FAHY,
Solicitor General.
SAMUEL O. CLARK, Jr.,
Assistant Attorney General.
SEWALL KEY,
JOSEPH M. JONES,
Special Assistants to the Attorney General.

MAY 1942.

U. S. GOVERNMENT PRINTING OFFICE 1942